

## Report of the President

The recession in the Netherlands Antilles persisted in the fourth quarter of 1998, reflected by a decline in real Gross Domestic Product of 0.5% on an annual basis. The decline in economic activities resulted from sluggish domestic spending related to the continuing uncertainties of consumers and investors regarding the government's policy towards the financial-economic crisis. The overall performance of the export sector also was weak, as a result of developments in the international financial and business services sector and the impact of hurricane George on the tourism sector in St. Maarten. The sluggish economic development was accompanied by an increase in the unemployment rate to 15.8%. Consumer prices, on the other hand, declined in the fourth quarter of 1998, compared to the third quarter of 1998, due mainly to the decline in oil prices and, subsequently, electricity and water prices, and the low inflation in our main trading partners. This development contributed to the further decline in the annualized inflation rate.

The overall weak export performance resulted from mixed sectoral developments. The tourist sector recorded an increase in the number of stay-over visitors and in foreign exchange income generated. However, the number of cruise passengers declined, due to fewer cruise calls. Developments by island varied. Curacao recorded a moderate growth in the number of stay-over tourists and an increase in foreign exchange income earned, while cruise tourism declined. In Bonaire, the decline in stay-over tourism continued, and the number of cruise tourists decreased. St. Maarten was affected by the passing of hurricane George in September 1998. Although the hurricane did not cause much damage, the growth in the number of stay-over and cruise tourists slowed, while the amount of foreign exchange income generated declined. Prospects for the tourist sector in 1999 are positive, owing to a marked increase in the number of charter flights, the attraction of well-known hotel chains, the construction of various new hotels, and the finalization of a golf course and a mega-pier for large cruise ships in Curacao. Furthermore, the free zone in Curacao performed well, reflected by a growth in both the re-exports and the number of visits.

Developments in the transportation sector were mixed. The national carrier Air ALM recorded a further growth in the number of passengers, but the amount of freight handled continued to decline. The Bank welcomes the recently agreed strategic alliance with Air Aruba and the Venezuelan airline Aserca, which will improve the prospects of returning the company to a profitable status. The number of passengers at the airport of Curaçao increased. This increase was due primarily to transit passengers, reflecting the airport's function as a hub. Activities in the harbor of Curacao increased also, as measured by total cargo movements and the number of ships piloted. In contrast, the harbor of Bonaire incurred a marked decline in the number of ships piloted, dominated by the fall in the number of tankers. The latter decline was related to the decrease in oil transshipment and oil storage activities on the island. However, these activities grew markedly in St. Eustatius. The ship repair sector recorded a decline in activities, as measured in man-hours sold, while an increase was seen in foreign exchange income earned. Finally, bunker sales showed a significant decline.

The oil refinery recorded a decline in production in the fourth quarter of 1998. Operational costs continued their declining trend, reflecting the success of the refinery's efforts to bring down production costs to competitive levels. The international financial and business services sector continued to perform weakly. This weak performance was reflected by a decline in both income received for services rendered and profit taxes transferred to the government. Despite the current weak development in activities, prospects for the sector look promising. This optimism is based on new initiatives, such as the private foundation and the establishment of a securities exchange, the latter expected to become operational in the second quarter of 1999.

Despite the weak development in exports, the deficit on the current account of the balance of payments improved. This improvement can be attributed to the decline in imports related to sluggish domestic demand. In addition, the surplus on the capital account improved considerably, because of the development in government capital. This development resulted from the increase in development aid received by the Dutch government. As a result, our foreign exchange reserves recorded a marked increase in the fourth quarter of 1998.

The General Government recorded a surplus on a cash basis in the fourth quarter of 1998, slightly higher than the surplus in the same quarter of 1997. This improvement was attributable entirely to the increase in revenues, which more than offset the growth in expenditures. The increase in revenues was due primarily to an increase in import duties related to the growth in transshipment activities to the European Community and a transitory windfall in inheritance and gift taxes. The growth in expenditures was due mainly to the purchase of goods and services and to transfer payments. In contrast, on an annual basis, the cash deficit of the General Government deteriorated to NAf 85 million, resulting primarily from higher expenditures. However, a considerable part of the increase also was attributable to the reduction of arrears to the civil servants pension fund APNA by the Central Government. Compared to the projected cash deficit of NAf 285 million, it is evident that the government continued to defer payments forced by increasing financing constraints. The Bank views this behavior with concern, as it further weakens the financial position of the private sector and masks the need for additional and immediate fiscal consolidation.

For 1999, the General Government's cash deficit is estimated at NAf 280 million, a considerable deterioration compared to the actual outcome in 1998. The main factors contributing to the deterioration are the replacement of the 6% sales tax (ABB) on the Leeward Islands by a 2% turnover tax and the reduction of the turnover tax on the Windward Islands from 3% to 2%, the reduction of income and profit taxes, the carry-over of expenditures from 1998, investments related to Y2K issues, and the settlement of the Parker guarantee. Although measures to reduce the tax burden are welcomed, they should be supported by measures aimed at a structural reduction in expenditures and, hence, the government deficits. Without such supportive measures, the lack of confidence will persist, and the tax reduction will prove ineffective in attaining a revival of the economy.

The money supply grew moderately in the fourth quarter of 1998, as a result of the increase in net international reserves. The domestic sector exerted a contractionary impact, attributable to the government sector. The monetary contraction in the government sector resulted mainly from an increase in deposits related to the cash surplus and the receipt of development aid from the Dutch government. Private sector credit growth was marginal, and the annual increase remained well within the 2.25% growth limit of the monetary cash reserve arrangement. Since January 1, 1999, the reserve requirement has become the Bank's main instrument to attain its monetary policy objectives. Any changes in the reserve requirement will depend mainly on the impact that the implementation of the government's recovery program has on the economy.

The uncertainties surrounding the implementation of the recovery program hamper the much-needed adjustments in our economy. Therefore, a realignment of the program is warranted. In this respect, the Bank welcomes the installation of the National Plan Commission entrusted with this task. To underpin the government commitment to further fiscal consolidation and to enhance the program's credibility, the current program should be comprehensive and directed to achieve a structural reduction of the fiscal deficits and the revitalization of the economy in line with, among others, the recommendations of the Interamerican Development Bank. Only this two-tier approach can bolster investors' confidence and create a climate conducive to economic expansion and, hence, job creation.

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